IMPROVING USDA'S EXPORT CREDIT PROGRAMS IN THE TRADE TITLE OF THE FARM BILL

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Mr. Chairman and Members of the Committee, my name is Kevin Becker. I am Senior Vice President in COBANK's International Banking Group. In response to the Committee's invitation, I am pleased to submit this testimony focusing on the importance of the USDA's export loan guarantee programs to U.S. agriculture. Exports are critical to the agricultural economy and COBANK has been actively involved in financing agricultural exports for many years. I am also pleased to provide the Committee with a number of suggestions for improvements in these important programs.

With $25 billion in assets, COBANK is the largest bank in the Farm Credit System. We provide domestic financial services to some 2,600 customers, who are also our member-owners. These member-owners include farmer-owned cooperatives, rural telecommunication companies, and electric systems.

Since 1982, COBANK has provided over $25 billion in loans to support the export of agricultural products. We currently process transactions for U.S. agricultural exports of more than $2.0 billion annually. To support our export business, COBANK maintains offices in Mexico, Argentina, and Singapore. We enjoy correspondent banking relationships with more than 500 banks in 80 countries worldwide.

In one important respect, COBANK is different from every other bank that operates in the international marketplace. We are involved in export financing only to support the export of U.S.-origin agricultural products. Moreover, our owners are the producers of those products. Accordingly, much of our financing is done under the USDA's export credit programs, where we are acknowledged as a key lending institution.

Our relationship with USDA is likewise unique. Because COBANK's international mandate is exclusively focused on promoting U.S. agricultural exports, we work closely with USDA officials in Washington, and with Foreign Agricultural Service officers around the world. Our focus is not just to lend under the GSM program, but to market it through individual meetings with foreign importers and banks, to make presentations domestically and overseas on the benefits of GSM, and to recommend program changes and enhancements that will improve the effectiveness of the program and create additional export sales for U.S. producers. COBANK is also an associate member of the North American Export Grain Association (NAEGA), an organization focused on improving the ability of U.S. farmers to compete in world markets.

I would like to focus on three main topics: 1) the importance of agricultural export credit programs in opening foreign markets to U.S. farm products; 2) key legislative recommendations that will enhance the effectiveness of our credit guarantee programs; and 3) other actions that can be taken to make these programs more effective for U.S. exporters. I would like to emphasize that the recommendations for legislative changes proposed in this testimony represent the consensus among farm and agriculture-related organizations that have participated in a Trade Title Working Group, Subcommittee on Export Assistance and Promotion Programs. Finally, I would like to briefly comment on COBANK's view of ongoing trade negotiations related to export credits.

Mr. Chairman, before I begin my specific testimony, I would like to add our voice in support of those who are urging the committee to provide full funding of all USDA export programs. As we enter into negotiations with our trading partners, it is critical that the U.S. begin those negotiations from the strongest possible position. The committee can ensure that position by authorizing export programs at the maximum level allowable under our existing trade agreements.

Export Credit Programs Open and Develop Markets

Export credit continues to be a critical tool for opening and maintaining markets for U.S. agricultural products. In markets where buyers and their banks do not have ready access to capital, export credit can make the critical difference in consummating a sale. In markets with more ready access to capital, a well-designed export credit program can provide the financial incentive needed to encourage buyers to specify U.S.-origin products.

Korea is a prime example. While a major importer of U.S. products, as recently as early 1997 Korea did not avail itself of our export credit program. The Asian financial crisis, which began in mid-1997, caused Korea difficulty in accessing financial markets. The GSM program became a critical tool both for alleviating a short-term liquidity crisis and for maintaining U.S. food exports to the Korean market. Today Korea has reached investment grade status and the liquidity problems of 1997 and 1998 are behind it. Nevertheless, GSM continues to make the deciding difference as Korean importers choose between U.S. agricultural products and other countries' products. The point is that the GSM program continues to be a critical tool for ensuring access for U.S. exports to markets, no matter where a country may be in the economic cycle.

Indonesia provides another example of the value of the GSM program. Since the beginning of the Asian crisis, Indonesia has been virtually unable to obtain meaningful amounts of credit directly from commercial banks. GSM-guaranteed loans, however, have continued to be available. GSM has enabled U.S. farmers to maintain and increase their penetration in this important market, not just in traditional products like soybeans and cotton, but also increasingly in wheat.

GSM is an important export promotion tool. However, unlike other promotional tools such as direct subsidies, GSM is only effective in markets where there is a credit need. The effectiveness of GSM is directly related to the degree to which it satisfies that credit need (or offers a credit alternative more attractive than borrowing in traditional commercial banking markets). Loans guaranteed under the GSM program carry a lower interest rate and a longer tenor (i.e., maturity) than unguaranteed commercial bank borrowing. The program makes credit available in markets where liquidity is tight, and provides an important financial incentive to buy U.S. products even in markets where credit is plentiful.

As an example of the importance of loan tenor in the GSM program, we have provided below a chart illustrating program usage by tenor in fiscal year 2000. Of a total of more than $2.5 billion in major commodity exports under GSM, less than $20 million (or less than 1% of GSM registrations) was sold using loans with a tenor of 18 months or less. The benefit and effectiveness of GSM is clearly at the longer tenors. In general, we can say that the longer the tenor, the more effective the program is at moving U.S. agricultural products overseas.

Exports financed under GSM in FY 2000 by loan tenor ***(millions of $)***

Product	*$ shipped*	*% of program*	*% sold at 2+ years*	*% sold at 3 years*
Oilseeds and	951.	32.5	99.9	56.2
Feed	701.	24.0	99.6	39.4
Wheat	435.	14.9	100.0	51.8
Cott	377.	12.9	100.0	55.9
Ric	65.	2.2	77.0	73.1
total	**2,531**	**86.5**	**99.3**	**47.7**

The Supplier Credit Guarantee Program ("Supplier Credit") tends to involve exporters and foreign buyers more than commercial banks. Supplier Credit has been less actively utilized than GSM generally, but it is still an important tool in making critical financing available for U.S. exports. As the purchase of commodities worldwide has tended to shift to the private sector and away from government buying entities, the creation of Supplier Credit represents a valuable attempt to tailor credit offerings to this private market.

As a result of the dedicated effort of officials at USDA, allocations under Supplier Credit increased from $360 million in fiscal 1999 to over $650 million in the current fiscal year. Usage has likewise grown from $46 million in fiscal 1999 to $140 million in the current fiscal year, representing a current annualized rate of $185 million. USDA officials demonstrated a keen understanding of the needs of exporters when they increased guarantee coverage under the program from 50% to 65% in fiscal 2000. This change definitely contributed to increased usage of the program.

Although to date the majority of the program (around 75%) has been used only in Mexico and Central America, the trend has been very positive. The Working Group believes that with program enhancements to increase coverage and to lengthen the available tenor, Supplier Credit will be an increasingly important tool for U.S. exporters.

The Facility Guaranty Program provides guarantees to facilitate the export of equipment that will contribute to additional U.S. agricultural export sales. This program was patterned after the Eximbank medium-term credit programs, but tailored specifically to the interests of agricultural exports. To date usage of the program has been disappointing. However, COBANK believes there are several ways in which the Facility Guarantee Program could be improved to enhance its effectiveness, increase its utilization, and generate additional farm exports. I will make specific recommendations later in this testimony.

Key Legislative Issues in Export Credit

Our existing export credit programs are well designed and effective in promoting U.S. export sales. As previously noted, COBANK and NAEGA have participated with a Working Group of farm and commodity organizations to develop recommendations that would refine the Supplier Credit Guarantee Program to make it more useful. The recommendations contained in this statement for legislative changes to Supplier Credit represent the consensus recommendations of that Working Group. Our recommendations for improvements to current export credit programs are relatively minor and require only simple revisions to current legislation, but will have a significant impact on the usage and value of the programs.

Increase Coverage under Supplier Credit

In the case of Supplier Credit, the Working Group strongly recommends that the percentage of guarantee coverage be increased. While the increase in coverage from 50% to 65% in fiscal 2000 was very helpful and resulted in increased utilization of the program, an increase to at least 85% would be necessary for the program to be truly effective. The Working Group further believes that a tiered guarantee arrangement, designed to provide higher guarantee coverage at shorter tenors, would make the program more useful. Specifically, the Working Group recommends coverage of 90% for credit terms of 90 days or less, and coverage of 85% for credit terms of 91 days or more. An increase in the guaranteed percentage would lead to a much-improved program.

Extend Supplier Credit authorized tenors to one year

Credit tenors under Supplier Credit are currently limited to 180 days. There are many instances where credit up to 360 days is appropriate and needed to support U.S. exports, yet not available under the current program. For example, the trading cycle for some agricultural products (e.g., cotton) might suggest a longer financing tenor. General market conditions and the credit offerings of our competitors also require us to meet the market by offering financing for longer than 180 days. The Working Group strongly recommends that the authorized tenors under Supplier Credit be extended from 180 days to one year.

Maintain the statutory cap on fees, but annualize Supplier Credit fees

Guarantee fees under Supplier Credit are subject to a statutory cap of 1%. The Working Group supports this cap, but believes the 1% limit on Supplier Credit fees would be better reflected as 1% "per annum." This qualification is important, since exports financed at shorter tenors, (i.e., 30 to 60 days) are now far too expensive because the 1% fee is not annualized and reduced to reflect the shorter tenor. A 1% "per annum" fee would mean that an exporter providing 30-day financing would pay a maximum premium of 1/12 of 1%, reflecting the fact that the risk is outstanding only for 1/12 of a year.

GSM-102 also carries a statutory fee cap of 1%. As with Supplier Credit, the Working Group believes that this represents an appropriate maximum level for GSM fees and believes that fees collected within the 1% maximum have adequately compensated the CCC for its outlays over the years[1]. This has been accomplished while maintaining fees well below the cap (the highest fee currently charged for a three-year guarantee under GSM-102 is 0.663%). The Working Group believes that any move to allow fees in excess of the 1% cap would be unnecessary and detrimental to the effectiveness of the program.

Reauthorize GSM

The authorization for the making of GSM credit guarantees (including Supplier Credit) under section 221(b)(1) of the Agricultural Trade Act of 1978 expires at the end of fiscal 2002. This authority needs to be extended at the current minimum level of $5.5 billion.

Maintain the same-bank restriction

Arguments have been raised to eliminate the restriction on a bank using the GSM program to guarantee loans to its foreign subsidiary or foreign parent corporation. COBANK believes this is an important restriction that safeguards the integrity of the program and prohibits financial institutions from making claims on the U.S. government for transactions which are essentially intra-company in nature. Without this restriction, a U.S. subsidiary of a foreign bank, for example, could theoretically make a loan to its foreign parent, guarantee that loan under the GSM program, and then file a claim for non-payment if its parent bank fails to repay the U.S. subsidiary. The current legislative restriction protects the integrity of the program and guards against financial abuse. COBANK recommends maintaining this restriction.

[1] We have analyzed CCC's outlays (claims paid and administrative expenses) as compared with receipts (fees collected) for the period 1981-1998. We have excluded those claims paid for credits that were renegotiated as part of Paris Club agreements, since these payments simply changed status from "officially supported credit guarantees" to "officially supported credits." Excluding war-related claims paid (i.e., claims related to Iraq), premiums over this period actually exceeded administrative expenses and claim payments.

Administrative Improvements to Export Credit Programs

I would like to comment on several administrative and regulatory areas where COBANK believes that both the Supplier Credit and GSM programs could be improved.

Maximize the use of tenors in GSM

For the GSM-102 program, tenors should be lengthened to the authorized maximum wherever possible. The maximum three-year tenor of GSM loans is critical to the program's success. GSM allows financing to foreign banks at rates lower than those generally available in the commercial bank market for similar tenors. More importantly, the longer tenors themselves are often unavailable in the market. The longer tenors available through GSM are the strength of the program.

Unfortunately, GSM usage in several of our key export markets, such as Mexico and Korea, is lower than it could be because the program is limited administratively to tenors of no more than two years, rather than the three-year maximum. Mexico is a prime example where tenors have been reduced as economic conditions in the importing country have improved. Since improved economic conditions and better access to commercial bank financing implies less of a comparative advantage for GSM financing, the response of USDA should be to lengthen tenors to the maximum in the better developed export markets.

Reduce GSM fees in developed markets

For the same reason, guarantee fees in the better developed markets should be reduced. As countries such as Mexico and Korea achieve investment grade status, a reduction in the relevant guarantee premium makes simple economic sense. The cost of the guarantee (i.e., the fee), along with the tenor of the loan are the two key elements which most directly control the effectiveness of the GSM programs.

Look for administrative efficiencies

COBANK believes that the GSM program can be made more effective for value-added products, rather than for just bulk commodities. Historically, the GSM program has been used mostly for bulk commodities; these constitute well over 75% of all products shipped under the program. Shipments of smaller amounts and of value-added products are discouraged because of complicated registration and administrative procedures. We continue to work with USDA to suggest a number of administrative changes which could streamline and simplify use of the GSM program for value-added shipments.

Supplier Credit Guarantee Program changes

Supplier Credit could be enhanced by developing a program to guarantee multiple export sales, rather the current procedure of guaranteeing one sale at a time. By developing a broad export guarantee or insurance policy, USDA could streamline the application and approval process for exporters, while reducing its own risk through diversification.

Facility Guarantee Program changes

Several program changes could contribute to increased usage of the Facility Guarantee Program. First, guarantee coverage should be increased. The Facility Guarantee Program continues to be underutilized primarily because financial coverage is limited when compared to other U.S. export programs. For example, Eximbank guarantees up to 100% of the financed amount for a project. The Facility Guarantee Program, on the other hand, covers only 95% of the financed amount.

Second, program qualifications should be relaxed. Current usage of the program is limited to projects that demonstrate immediate U.S. agricultural export increases. The qualifying guidelines were originally conceived to deter any misuse of program funds – an understandable goal. However, experience has shown that it is extremely difficult to demonstrate an immediate increase in U.S. exports. This is due to the fact that agricultural export volumes follow the same long-term cycles that American farmers need to contend with. These long-term (at least one year) agricultural cycles are in conflict with the immediacy of the qualification terms. Moreover, the Facility Guarantee Program requires that it be the equipment exporter who demonstrates the link to increased U.S. export sales; many equipment exporters are not in the best position to make this determination. U.S. commodity trade associations would be in a better position to make an assessment of the long-term potential of a project to support increased U.S. export sales, since promoting this goal is part of their role and mission.

Third, reasonable foreign content in projects should be allowed. International projects will naturally include some components that are not of U.S. origin. Foreign countries are interested in technology transfer and partnerships that help develop their country, without focusing on product origin. The Facility Guarantee Program should continue to promote U.S. technologies and products while taking into account local content issues. This not only resonates well with the foreign purchaser, but also takes into account the reality that the current U.S. content requirements are too restrictive. The focus should instead be the long-term impact on U.S. agricultural exports.

Also, COBANK's authority to finance facilities in foreign countries, exports of farm machinery and processing equipment is somewhat limited in scope. We believe some adjustments in those authorities would better enable us to finance infrastructure and equipment that will make U.S. exports more attractive to purchasers. We are currently discussing these issues with our member-owners and other agricultural groups and expect to offer specific proposals in the near future.

Trade Negotiations on Export Credit

In recent meetings of the Organization for Economic Cooperation and Development (OECD), U.S. negotiators attempted to reach a consensus agreement on agricultural export credit, but these negotiations appear for the time being to be at an impasse. COBANK views this impasse as a positive development. If implemented, the OECD draft proposal would restrict the maximum allowable tenor of GSM loans to only 18 months. As noted earlier in this testimony, less than 1% of current exports under GSM are financed for tenors of 18 months or less.

In addition, the proposal would increase the cost of the program through higher fees to the point where the financial incentive to purchase U.S. products could be completely lost in our most important export markets. Specifically, the proposal would require Congress to repeal the 1% cap on fees, and would put fees on a risk-based basis similar to the current OECD Arrangement for Officially Supported Export Credits. Using a formula similar to the existing OECD Arrangement (which was developed for the export of capital goods), current GSM fees could be from three to ten times higher, depending on the country of the importer.

COBANK believes that such fee increases would have a debilitating effect on the usefulness of the GSM program. Coupled with the reduction in tenor noted above, COBANK believes the proposal could render the GSM program virtually useless. We have expressed our objection to the OECD proposal in previous congressional testimony. Our objection was based in part on the fact that a negotiated agreement in the OECD would have literally forced Congress to eliminate the fee cap without sufficient review of the impact of such a change.

While the OECD draft proposal would significantly reduce the effectiveness of our agricultural export credit programs, the proposal does not offer any protection against additional attacks on our programs in the full WTO. In fact, the OECD proposal stipulates that there will be further negotiations on export credit in that forum. Finally, the proposal does practically nothing to curtail the export assistance programs of our competitors.

When discussions on export credit are taken up again in the full WTO, we hope that U.S. negotiators remain mindful of the important role the GSM program plays in ensuring market access for U.S. products and for providing attractive financial incentives to buyers. We hope that they will no longer negotiate export credits in isolation, and will demand significant concessions from our foreign competitors on foreign export subsidies and limitations on the activities of foreign state trading enterprises.

Conclusion

In closing, I reiterate our view that our export credit guarantee programs for agricultural have been effective in opening and maintaining markets for U.S. farm products. As a result of these programs we have enhanced farm income, created export jobs and provided an effective tool for U.S. exporters to utilize when competing in foreign markets. These important programs need to be reauthorized to continue in operation, and should be enhanced by implementing the statutory and administrative modifications suggested in this testimony. Thank you very much for the opportunity to share our views regarding our U.S. agricultural export programs.